

Allowability of Legal Fees in Fraud Cases

Can contractors charge their legal fees to government contracts when IG agents investigate them for allegations of fraud? Legal fees incurred by corporations are a normal cost of doing business. Generally these costs are borne by the government on cost reimbursable contracts as part of the company's General and Administrative (G&A) expense rate. If legal costs have a direct benefit to a particular contract, the costs are a direct charge to that contract. In order for legal costs to be allowable on government contracts, the costs must be reasonable in nature and amount, allocable directly or indirectly through G&A to government contracts, and not otherwise unallowable.

Federal Acquisition Regulation (FAR) 31.205-47 is the cost principle that applies when a government contract is investigated for fraud.. It makes the allowability of these legal fees dependent upon the outcome of the legal proceedings. Proceedings include investigations by the IG. A criminal conviction or a finding of liability in a civil fraud action renders the legal fees and their associated costs (administrative, clerical, accountants, consultants, and experts) unallowable on government contracts. If the investigated conduct results in a termination of a contract for default by reason of a violation of law or a decision to debar or suspend a contractor or to rescind or void a contract, the legal costs associated with the investigation are unallowable as well.

The Justice Department may enter into an agreement with the contractor on the extent of allowability as part of a settlement or plea bargain. The legal costs will be recognized as provided in the agreement.

Where the contractor prevails in a legal proceeding (e.g., an acquittal, or a finding of no liability), the costs may be allowable, assuming that they are reasonable and otherwise allocable to the contract. However, contracting officers can negotiate a ceiling on the payment of these costs. In no event shall reimbursement exceed 80% of otherwise allowable legal costs associated with the fraud proceeding.

In *qui tam* cases which result in a settlement and in which the United States does not intervene, reasonable legal and associated costs may be allowed if the contracting officer, in consultation with his or her legal advisor, determines that there was very little likelihood that the relator would have been successful on the merits of the case. This determination is also subject to the 80% ceiling on payment of legal costs..

Sometimes contractors also pay for the representation of individuals or other entities under a requirement of a state's particular business law. Where the contractor is not legally obligated to provide a defense and the participant is convicted or found liable, the costs are unallowable on government contracts.

Legal and other costs associated with investigations and other fraud proceedings must be segregated and accounted for separately. Contracting officers generally withhold payment of these costs during the pendency of the proceedings. Where it is in the best

interests of the government, however, the CO can conditionally pay these costs upon provision of adequate security or other assurance, when the contractor agrees to repay all unallowable costs, with interest, if the costs are subsequently determined to be unallowable.